SUPREME COURT, U. S.

Office-Supreme Court
FILED
SEP 11 196
JOHN F. DAVIS, CL

In the

# Supreme Court of the United States

OCTOBER TERM, 1967

No. 278

J. GORDON TURNBULL, INC.,
*Petitioner,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

*On Petition For A Writ of Certiorari To The United States Court of Appeals For The Fifth Circuit*

## PETITIONER'S REPLY BRIEF

WENTWORTH T. DURANT,
RONALD M. MANKOFF,
3434 First National Bank Building,
Dallas, Texas,
*Counsel for Petitioner.*

WARLICK PRESS, INC.—P. O. BOX 10543—2269 VALDINA STREET—DALLAS—ME 1-3130

In the

# Supreme Court of the United States

OCTOBER TERM, 1967

---

No. 278

---

J. GORDON TURNBULL, INC.,

*Petitioner,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

---

*On Petition For A Writ of Certiorari To The United States Court of Appeals For The Fifth Circuit*

---

## PETIONER'S REPLY BRIEF

Respondent properly states the question in this case: whether Petitioner was immune from liability under §102 of the Internal Revenue Code of 1939, either as a matter of law, under the particular language of the 1939 statute, or, as a matter of fact, because of the peculiar need for accumulation which falls upon a liquidating corporation. (Memo. p. 1)

Respondent does not, however, properly relate this issue to the larger question: whether Congress intended that the accumulated earnings penalty may be applied to corporations "in liquidation" on the same basis as it applies to "going" corporations.

The 1939 Code provision, §102, by its own terms, could not apply to a liquidating corporation. That section required a corporate purpose of avoiding *surtax* on shareholders. Under the 1939 Code, a corporation could not pay a dividend subject to surtax "after deciding to quit with intent to liquidate the business". *Canal-Commercial Trust & Savings Bank v. Commissioner*, 63 F. 2d 619, 620 (5th Cir. 1933); *Shore v. Commissioner*, 286 F. 2d 742 (5th Cir. 1961). Once it had made the decision to "quit", Petitioner could not have effected a distribution subject to surtax; therefore, refusal to distribute did not "avoid surtax."

The 1954 Code employs the phrase "purpose of avoiding the income tax" rather than "surtax on shareholders". This may change the strict statutory result, but does not alter the intended purpose of this penalty: i.e., to extract dividends from going corporations "formed or availed of" to participate in an earnings' accumulation scheme intended to avoid taxes.

While we cannot hope to redirect the philosophy of every court which has directed its focus to the mathematics of accumulation rather than to the "purpose" of tax avoidance which is actually intended to be penalized, we can with confidence state that in the narrow area of corporations entering upon a purposeful liquidation, the application of this penalty must be narrowly construed to avoid unintended disastrous consequences. Contrary to Respondent's contention (Memo. p. 4), the purpose of §102 is not subverted by the accumulation of earnings followed by a liquidation. For, in that case, a second tax on the distribution of corporate earnings in liquidation would be imposed. No more can be

asked. Moreover, if the liquidation is aimed at tax avoidance, the personal holding company penalty (§541, et seq.) is the provision of the 1954 Code which is intended to attack it.

If the accumulated earnings penalty is to be an income-producing revenue device, then Congress must so legislate it. As it stands, however, this penalty is solely a tax-avoidance deterent. Its sole purpose is to penalize a particular tax avoidance device, *viz.*, the corporate accumulation of its *current* earnings under circumstances which indicate that dividend distribution would be an appropriate management decision. This penalty cannot apply where corporate distribution of all assets, including earnings, has been honestly decided upon and is deferred over year's end only to protect the rights of creditors according to the legal duty of liquidating trustees or directors.

There is an irreconcilable conflict between the fact that Petitioner made this corporate decision to distribute earnings in liquidation, and the power claimed and exercised by both courts below to hold that Petitioner's was a decision to accumulate its earnings to avoid tax to its shareholders. If, as the Tax Court found, Petitioner was in the process of "winding up its affairs", and if, as this finding implies, the process of marshalling assets followed upon a bona fide corporate decision to honor the late Mr. Turnbull's instructions to liquidate, then the courts below were not free to look to a mere procedural presumption to find a contrary intent for Petitioner's *subsequent* failure to declare a dividend. The legal duty of a liquidating corporation to protect its creditors

overrides any such possibility of substituting judicial hindsight for contemporaneous managerial decision. The courts cannot properly insist that corporate management break the law and distribute liquidating dividends while conceded *or* contending creditors are unsatisfied.

Respondent argues from the dearth of cases on this point that the issue involved is unimportant. Our conclusion is the exact opposite. The fact that this penalty has not heretofore been imposed by the Commissioner on liquidating corporations reflects admirable administrative restraint in a broad and heretofore questionable area.

That this is the first case which imposes this penalty on a corporation actually found to be intending liquidation, establishes its importance.

If the Tax Court had denied the fact of Petitioner's "winding up", pursuant to the explicit instructions of its deceased owner, the question might be otherwise. But, as it stands, and on the facts as they have been determined, this case creates new and potentially disastrous law; the imposition of this penalty on a corporation which has *as its purpose*, the marshalling of assets in anticipation of liquidation. This marshalling has been held by the courts below to be the accumulation of earnings; the prospect of liquidation has been held to reduce the corporation's need for such accumulations; and the pendency of filed lawsuits claiming much of the assets to be marshalled has been found to be irrelevant because of events in later years. This cannot be the atmosphere that gives rise to a penalty expressly legislated and worded to apply on tax avoidance purposes only.

For these reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

WENTWORTH T. DURANT

RONALD M. MANKOFF

September 8, 1967

## CERTIFICATE OF SERVICE

The undersigned certifies that service of this Petition has been made on counsel for Respondent and the Solicitor General by deposit in the United States Mail, duly addressed with proper air mail postage attached.

WENTWORTH T. DURANT

September 8, 1967